Budget Tidbits. . . just the facts

By Sen. Joe Zarelli, Ranking Republican
Senate Ways & Means

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Pension Funding Policy – Not a Good Start, Part II

After punting last session, the legislature faces two significant pension funding issues this year. Last week's brief looked at the plan 1 unfunded liability. This week: gain-sharing.

A. Gain-Sharing: It is NOT a plan to split the carries of Shaun Alexander . . .

- Instead it is a pension benefit the legislature passed in 1998 that was supposed to use "extraordinary investment gains" in the stock market to enhance government employees' pensions –at no cost.
- Here's how it works: When the pension system's average investment returns over four years exceed 10% annually, half of such excess returns are used to increase plan 1 & plan 3 employees' benefits.
- Here's the problem: Originally portrayed as having no fiscal cost, gain-sharing was determined by a new state actuary to be a material liability. The reason for the cost is simple:
  - The state assumes an 8% annual rate of return on pension investments. This is the long-term average the pension system must receive in order to be fully funded. Yet skimming off the high returns makes the return assumption untenable. As explained by the state actuary:
    - "*What is apparent from [] history is that these periods of high returns are needed to balance the similarly frequent periods of low returns so that the average rate of return is close to the actuarial assumption.*"[1]
  - And when the return assumption is untenable? The difference must be made up via increased contributions by state & local government – i.e., taxpayers.

B. How Much Does Gain-Sharing Cost?

- Short-term: The legislature last session "ignored" the issue, neither funding nor repealing the benefit. Had it been funded, gain-sharing would cost $147 million general fund this biennium. This is *twice the funding for the state parks' system* and *the equivalent of 15,000 new college enrollments*.
- Long-term: Over 25 years, ***gain-sharing represents a $7.8 billion cost to taxpayers*** (state & local gov't costs combined).[2]
- The costs are not immutable. When it passed gain-sharing, the legislature expressly retained the right to repeal the benefit, an authority the attorney general upheld in a recent opinion.[3]

C. Governor's Approach – Ignore the Issue

- With a nearly $8 billion cost over 25 years, the question of what to do with gain-sharing – fund it, repeal it, or replace it with another benefit – is one of the most significant issues of the session.

- Unfortunately the Governor's budget continues to ignore the issue – choosing to neither fund, repeal, or replace the benefit. Ignoring the issue, however, does not make it go away.

Bottom Line

Gain-sharing is a nearly $8 billion prospective cost to taxpayers. It is irresponsible to punt this issue yet again. The governor did not show leadership; the legislature must do better.

1. Select Committee on Pension Policy, Gain-Sharing Study, p. 9 (Dec. 2005)

i. *Id.*, p. 11 ($4.3 billion state cost & $3.5 billion local government cost from 2006-2031)

ii. Attorney General Opinion 2005, No. 16 (Issued Nov. 2, 2005).